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Chairman, Anthem Homeowners Council Liaison Committee &  
Chairman, Anthem Country Club Homeowners Association, Inc. Finance Committee

**BEFORE THE ARIZONA CORPORATION COMMISSION**COMMISSIONERS

MARC SPITZER - CHAIRMAN  
WILLIAM A. MUNDELL  
JEFF HATCH-MILLER  
MIKE GLEASON  
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF  
ARIZONA-AMERICAN WATER Company,  
INC., AN ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE CURRENT FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR INCREASES IN ITS  
RATES AND CHARGES BASED THEREON  
FOR UTILITY SERVICE BY ITS SUN CITY  
WEST WATER AND WASTEWATER  
DISTRICTS.

Docket No. WS-01303A-02-0867

IN THE MATTER OF THE APPLICATION OF  
ARIZONA-AMERICAN WATER Company,  
INC., AN ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE CURRENT FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR INCREASES IN ITS  
RATES AND CHARGES BASED THEREON  
FOR UTILITY SERVICE BY ITS SUN CITY  
WATER AND WASTEWATER DISTRICTS.

Docket No. WS-01303A-02-0868

IN THE MATTER OF THE APPLICATION OF  
ARIZONA-AMERICAN WATER Company,  
INC., AN ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE CURRENT FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR INCREASES IN ITS  
RATES AND CHARGES BASED THEREON  
FOR UTILITY SERVICE BY ITS MOHAVE  
WATER DISTRICT AND ITS HAVASU WATER

Docket No. WS-01303A-02-0869

Arizona Corporation Commission  
**DOCKETED**

FEB 04 2004

DOCKETED BY

CARL

DISTRICT.

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER Company, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS AGUA FRIA WATER DISTRICT AND ITS ANTHEM / AGUA FRIA WASTEWATER DISTRICT.

Docket No. WS-01303A-02-0870

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER Company, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS TUBAC WATER DISTRICT.

Docket No. W-01303A-02-0908

**NOTICE OF FILING  
CLOSING BRIEF OF FRANK J. GRIMMELMANN**

**Frank J. Grimmelmann**

**Anthem Resident &**

**Chairman, Anthem Homeowners Council Liaison Committee &**

**Chairman Finance Committee, Anthem Country Club Homeowners Association, Inc.**

The following is a summary of the significant issues set forth in the testimony of Frank J. Grimmelmann as an Intervenor in the proceeding on Arizona-American Water Company, Inc.'s (the "Company") application requesting a permanent combined rate increase in the company's water and waste water operations serving the residents of Anthem, Arizona, among other jurisdictions. A full discussion of various key issues associated with Company's rate increase request, and a theory and rationale supporting both Staff and RUCO's recommendations are contained in Mr. Grimmelmann's verbal, and summary and surrebuttal written testimony that was formally introduced into the record during the proceeding. The significant issues in this case and the supporting testimony addressed by

my testimony steadfastly remain: 1) reducing the rate increase proposed by the Company for the Anthem Water and the Anthem/Agua Fria Waste Water rates, and adopting Staff's recommendations (supported by RUCO's testimony) with regard to these rates, 2) supporting Staff and RUCO's proposed adjustments related to the Company's proposed rate increase 3) strongly recommending use of the original cost OCDB revenue basis methodology, denying application of the replacement cost RCND methodology (even partially as proposed by staff), 4) introducing evidence on the effect of the current level of inflation in setting an appropriate equity rate of return for the Company 5) requesting the denial of any combined water and sewer rate increase until the company demonstrates improvement in its delivery and quality, and 5) supporting a conservation incentive that is revenue neutral but equitable to customers resulting in urging the Commission to deny Staff's recommendation and consider the Company's proposal which is not in the evidence. Our closing position on these issues is summarized as follows:

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Quality of Service—The public comments at Anthem that drew in excess of an estimated 1,000 people, with 80 some odd cars turned away, emphasized problems with the quality of the water, the quality of customer service and billing, and an overall degradation in service quality at a time when Company seeks a rate increase. The Commission in a prior ruling indicated that there should be no increase in rates that recognizes or permits the Company to recover the acquisition premium until the Company demonstrates clear and significant benefits to its customers. We urge the Commission to adhere to this principle whether through approving direct rate increases or allowing adjustments that essentially produce an equivalent result.

Support for Staff and RUCOs' Recommendations— The following principals and points remain consistent throughout my testimony and highlight my present position: 1) As a community Anthem presently pays the highest rate relative to other water systems under review for services due to the unique nature and high quality of our 'state of the art' water infrastructure. 2) Under the present Commission rate setting methodology, there are legitimate differences in the cost of water at Anthem and other communities since ground water is not used since all water is pumped from CAP though a state of the art water treatment system, and the higher costs associated with meeting current code and more recent construction. 3) The Company's last proposed increase in their rejoinder testimony still results in a 16.05% increase (-0.82% decrease in Anthem Water plus 36.53% increase in Anthem/Agua Fria Wastewater) for the combined Anthem Water and Waste Water bill for an average customer. 4) While the Company's presently proposed increase represents a significantly reduction from their initially proposed direct filing for a 32.45% increase (over a comparable period of 11.9% inflation), it is still not supportable based upon either Staff or RUCO's analysis. Note that these increases refer to the bill for an average residential customer and not the Company's corresponding revenue rate increase which is discussed at the end of this section specifically. 4) Therefore, the Company's proposed increase when measured against an average customer's bill remains inequitable and inappropriate when applying appropriate methodologies, supported by the combined overall recommended Staff and RUCO rate reductions of 11.41% and 2.48% respectively, i.e., the Company requests a 16.05% combined increase when Staff and RUCO recommend a substantial overall reduction in the average bill for a customer. 5) Recognize that this proposed increase is over an existing base water rate that is already the highest rate in the area for the districts under review, and substantially higher than the average of the other COMPANY water & sewer rates. 6) Staff, and RUCO, which is charged with advocating for

consumers in the case of any proposed water utility rate increase, are the appropriate bodies to review the detail of a highly complex application for a rate increase and we generally support their analytical methodology and their conclusions, 7) The one area that we disagree with is Staff's proposal to use a 50% OCDB/50% RCND basis which is discussed separately below, although given Staff's methodology this does not affect Staff's recommended proposed revenue that we agree with, 8) Both Staff and RUCO appear to have given particular and appropriate focus to the proposed Anthem increases, having undertaken a thorough audit to review among other issues the capacity, capital and cost allocations that were used to establish the initial base rates, and appropriate present rates under the present State's rate setting methodology, and we concur with Staff's recommended rates and revenue levels. 8) We therefore urge the Commissioners to support Staff's recommendations, which are generally supported by RUCO's analysis, for an appropriate rate level based on the application and supporting evidence submitted by Company (still with the exception of using RCND for the calculation of the basis for the required revenue calculation and rates). This recommendation translates to a 28.56% decrease in the Anthem Water revenue rate (versus the Company's proposed -.32% reduction), and an 8.35% reduction in the Anthem/Agua Fria Wastewater revenue rate (versus the Company's proposed 16.68% revenue rate increase). Note that if the Company's combined 5.08% revenue rate increase proposed in their rejoinder testimony is granted, it unfairly rewards them through the application of inappropriate principles that potentially set a dangerous precedent for Arizona Consumers and future rate cases based on the findings of Staff and RUCO.

Support for Staff and RUCOs' Recommended Adjustments—We recognize legitimate differences in the Cost of Anthem water due to a variety of factors outlined in the testimony. However, the Company's proposed increase in the combined water and sewer rates remains unacceptable based on proposed Staff and RUCO adjustments, primarily due to the proposed sewer rate remaining higher than the rate of inflation during the period under review over an already high base, as Staff has concluded in its analysis. This is supported and evidenced by both Staff and RUCO's recommended adjustments that if adopted result in a proposed decrease in Anthem's combined rates for sewer and water. Upon reviewing the evidence objectively, we as a community support the recommended adjustments and continue to urge the Commission to either reject the application entirely, or apply the findings of staff to reduce the rate base, as supported by my testimony. Staff and RUCO's individual analyses once again support the application of well documented adjustments to the application based on acceptable and supportable methodologies applied in the State of Arizona.

Considerations on the Appropriate Rate of Return—Staff and RUCO's foundation for a fair and equitable Rate of Return based on the application of the Capital Asset Pricing Model ("CAPM") is the accepted foundation for our market mechanisms and the pragmatic operation of the capital markets produces a fair and adequate rate of return for the Company in determining rates, although the use of discounted cash flow is also acceptable. The rate of return required to attract investors and necessary capital during a period of low inflation is substantially lower than that requested by the Company. While my testimony provides an economic foundation for these conclusions, Staff and RUCO have more than adequately supported these conclusions in their testimony. Therefore, we

support the rate of return recommended by Staff and/or RUCO, assuming that the Commission does not elect to simply deny the Company's application.

Use of RCND versus OCDB for the Revenue Base—The 'required revenue for the Company is equal to the revenue base times the appropriate rate of return', based on consistent historical Arizona Rate Setting Methodology and supported by Staff and RUCO analyses. We continue to urge the Commission to deny the Company's request to use 100% RCND and the Staff's proposal to use 50% RCND/50% OCDB for the revenue base. We concur with RUCO and recommend the use of 100% OCDB for the revenue base since we firmly believe that RCND provides a dangerous, confusing and inappropriate foundation for rate setting, in spite of the fact that it has been employed in Arizona in the past. The danger arises from the fact that both the Company and Staff suggest RCND for the basis, but on the other hand the Company holds the required rate of return constant, while the Staff holds the required revenue constant. The result is that the Company concludes that an unsupportable and egregiously high revenue requirement is necessary, while Staff's required revenue for the Company is revenue neutral whether RCND or OCDB is employed in the calculation. We view conceding the use of RCND as a dangerous precedent since it confuses both consumers, and the process, and may also result in investor confusion if the required revenue remains constant as proposed by Staff. We therefore continue to support the use of 100% OCDB revenue base for the clearest and most appropriate calculation of the required return utilizing a market determined rate of return, and agree with the required return proposed by Staff in this regard.

Additionally, once RCND is allowed, the Company will argue, as it has, to hold the appropriate economic rate of return at a market level to produce a higher revenue requirement. Should this be granted by a future Commission or a court on appeal, the economic foundation for RCND stifles the Company's innovation and encourages the replacement of existing assets without consideration for productivity gains that the adoption of new technologies, processes or regulatory changes may produce. This in turn would produce a 'potential windfall' for the Company that may or may not actually ever have to be spent by the Company if such innovations emerge in the future.

Company Proposed Conservation Oriented Rate Design Schedule—While we are conceptually in agreement with Staff in recommending an inverted three-tier rate design to promote efficient water use by sending an economic signal to future Company customers, we do not support Staff's recommended approach since their proposal does not appear to fairly distribute cost to customers or appropriately align economic incentives. In short, the Staff model creates further inequity among customers, particularly since it continues to penalize customers based on their meter size versus their water usage which seems to offer a more appropriate economic alignment. Staff's proposal ignores customer type and meter size resulting in an inequitable impact on residential customers required to use a larger meter size due to code requirements, in particular sprinkler systems. Essentially, the size of the meter is totally independent of the water usage of a home and conservation incentives.

In response to Staff's testimony and to provide an alternative that we can support for the Commission's consideration, the Company distributed a proposed plan that was not filed in a timely manner and is therefore not included in the testimony. Nonetheless, we support

the Company's proposed conservation-oriented rate structure involving the use of inverted-block rates. We support the adoption of the conservation structure for residential customers without consideration of the size of the delivery pipe. Further, we make no comment on the structure for commercial customers since we have not had an adequate opportunity to assess the suggested break points and rates for this class of service that will affect Anthem's cost of water for common areas supported by the home owners associations.

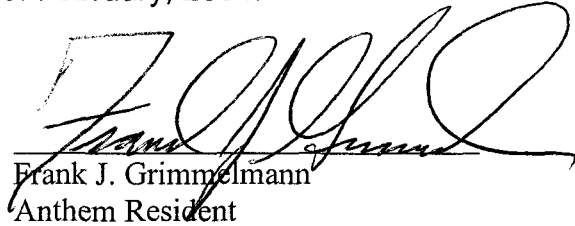
The Company's proposal seems preferable to the structure previously proposed by Staff even though it is not presently introduced into evidence. Based on our analysis of the proposed break-points of 4,000, 10,000 and 10,001+ gallons per month with corresponding rate differentials of 70%, 120% and 180% for residential customers, the proposal seems equitable, subject to Staff and RUCO confirming that the proposals are indeed revenue neutral for the Anthem Water District as a whole, applying the revenue rates ultimately approved by the Commission.

Recommended Action In View of these Facts--Granting any increase in the combined water and sewer rates rewards the Company unfairly, particularly in view of their continued poor quality of service to the Anthem community, and supported by the conclusions in Staff and RUCO's independent analyses. Specifically, in an earlier ruling, the Commission indicated that any acquisition premium would not be recoverable unless there was a measurable and observable benefit to the customers, and it seems however disguised that this is the intent of the Company in submitting its proposed rate increase. The Company should have considered the price it paid for the assets based on the cash flow available to adequately cover debt service, and considered its recovery of its acquisition premium at the present or the proposed reduced rates through improved operational performance and management. The public comment at Anthem, supported by over 1,000 residents, suggests that the no benefit has emerged from the Company's acquisition of Citizen's Water Company, given the quality of water, the quality of customer service and billing, and the overall degradation in service quality at the same time that the Company is seeking an increase in rates.

We urge the Commission to consider and support Staff and RUCO's recommendations in rendering its final decision on our community's rates. We also strongly urge the Commission to consider employing ODCB as the appropriate revenue base methodology, and to deny even the partial use of RCND as an accepted methodology, regardless of whether or not the revenue requirement remains the same under the application of both methodologies or through applying a combination of the two. Finally, we support the adoption of the Company's new proposed graduated rate structure to promote water conservation that is revenue neutral to consumers, and offer no conclusion on the proposed break-points for commercial users since we do not have the information or time to assess these break-points against our community's usage of water for the common areas requiring water usage by the home owners associations.

This Commission's action to support these recommendations provides a vote of confidence for your constituents in Anthem, while providing a fair and equitable rate of return for the Company based on accepted methodologies historically employed in the State of Arizona, and the facts set forth in the course of the hearing.

RESPECTFULLY SUBMITTED this 4th day of February, 2004.

A handwritten signature in black ink, appearing to read "Frank J. Grimmelmann", written over a horizontal line.

Frank J. Grimmelmann

Anthem Resident

Chairman, Anthem Homeowners' Council

Liaison Committee, and

Chairman, Anthem Country Club Homeowners  
Association, Inc. Finance Committee

AN ORIGINAL AND TWENTY-ONE COPIES  
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of February 2004 with:

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